AGENDA ITEM E-17

CITY OF LODI
COUNCIL COMMUNICATION

AGENDA TITLE: Authorize Staff to issue Letter of Opposition Relating to AB 573 (Wolk), which would Restrict the Types of Indemnification Clauses that may be Included in a Public Agency Contract with a Design or Engineering Professional or Firm.

MEETING DATE: June 21, 2006 City Council Meeting

PREPARED BY: City Attorney

RECOMMENDED ACTION: That the City Council oppose AB 573, which would restrict the types of indemnification clauses that may be included in a public agency contract with a design or engineering professional or firm.

BACKGROUND INFORMATION: AB 573 is yet another attempt by the State Legislature to direct the terms that a city can negotiate with a contracting party. It represents a disturbing trend by government service firms who do not like the terms they can negotiate to run to the legislature and seek prohibitions on what otherwise should be a market driven transaction. AB 573 would specify an indemnification provision that does not allow a public agency to adequately manage its potential liability, thus limiting the options available to public agencies to protect their taxpayers. Although harmless on its face, limiting cities from demanding indemnity for more than the fault of the design or engineering firm, AB 573 would be detrimental to public agencies because in the typical lawsuit, it will result in refusal by the Architecture and Engineering ("A/E") consulting firm or its insurance carrier to provide a legal defense for the public agency prior to a full trial. Similarly, AB 573 could limit the public agency's benefits under any additional insured provisions in the A/E consulting firm's insurance policy.

AB 573 would benefit A/E consulting firms and their insurance carriers at the expense of the public in two ways. First, the net effect would be to shift to taxpayers legal defense costs that should be borne to varying degrees by A/E consulting firms and their insurance carriers. Second, it would encourage protracted litigation because, as a practical matter, a formal finding of negligence or intentional misconduct will be a prerequisite for the public agency to receive indemnity from the A/E consulting firm or its insurance carrier.

AB 573 would give A/E consulting firms an excuse to deny indemnity to public agency clients where there is any plausible contention that the public agency contributed to the loss, even if the A/E consulting firm was primarily responsible. Under most circumstances the public agency's degree of responsibility for a loss is minor and passive compared to that of the A/E consulting firm that was paid to perform a professional service.

The negotiation of terms between public agencies and A/E consulting firms should be left to the free-play of market forces. AB 573 would preclude negotiation of broader protection, even where the public agency is willing to pay extra for such protection. The competitive market for A/E services is robust. A/E consulting firms are experiencing robust growth and do not need any additional protection from the Legislature. (See, Market Returns to Prosperity, *Engineering News Record,* p.54 (4/18/2005).) Public

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APPROVED: James R. Krum
for Blair King, City Manager

agencies have ample choices for A/E services to deliver their projects. Under these circumstances, it is unnecessary for the Legislature to step in and forbid certain types of indemnity agreements. As with any contract terms, whether the amount of fee or indemnity, A/E consulting firms may always choose to withhold their agreement and do business elsewhere.

In 1997, California enacted AB 994 (Sweeney), which mandated that public agencies include in their Requests for Proposals for A/E services a notice regarding the indemnity provisions that would be included in any professional services agreement. At that time, the A/E consulting firms argued that AB 994 "would give architects up front notice as to any indemnity conditions of the contract so that they can properly recognize those costs in their bids or negotiate with the local agency for a more mutually acceptable indemnity provision." (See, AB 994 Assembly Bill Analysis.) AB 994 was a fair and reasonable requirement that was not opposed by California local governments. Today, AB 994 works as intended so that A/E consulting firms can choose not to submit a proposal to a public agency if it finds the indemnity provision unacceptable. Thus, the City of Lodi does not believe that further legislation is necessary.

In substance, AB 573 is identical to several prior bills that were rejected or vetoed. (See, for example, SB 1915 (Figuera 2004); AB 1839 (Campbell 2002); AB 1070 (Campbell 1997 – 1998). The sponsors may intend that AB 573 have an appearance of fairness, but if enacted it will actually lead to numerous unintended consequences that are detrimental to California public agencies, including cities. While the sponsors provided several examples of cities that include "fair" indemnification provisions in their contacts, our sampling of some of the cities on the list indicates that those cities were either no longer using those provisions, had used them in a special situation only, or were reviewing their continued use of those provisions.

D. Stephen Schwabauer
City Attorney

FISCAL IMPACT: None.

FUNDING: N/A

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CITY OF LODI
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June 22, 2006

Assembly Member Lois Wolk
State Capitol, Room 6012
Sacramento, California 95814

Re: AB 573 (Wolk) – Indemnification/Design Professionals

Dear Assembly Member Wolk:

On behalf of the City of Lodi, I regret to inform you that the City must respectfully oppose AB 573. This measure would restrict the types of indemnification clauses that may be included in a public agency contract with a design or engineering professional or firm. Instead, it would specify an indemnification provision that does not allow a public agency to adequately manage its potential liability, thus limiting the options available to public agencies to protect their taxpayers.

The basis of the City's opposition is as follows:

The nature, scope and magnitude of risks are unique to each project, whether it is a school, airport, street, bridge, city building, seaport, or hospital. The parties who are in the optimal position to fairly allocate the unique risks of a particular infrastructure project are the public agency and the A/E consultants with which it negotiates. These parties know the site conditions, the design program, the schedule and the capabilities and capacities of each party to effectively manage the project.

AB 573 would be detrimental to public agencies because in the typical lawsuit, it will result in refusal by the A/E consulting firm or its insurance carrier to provide a legal defense for the public agency prior to a full trial. Similarly, AB 573 could limit the public agency's benefits under any additional insured provisions in the A/E consulting firm's insurance policy.

AB 573 would benefit A/E consulting firms and their insurance carriers at the expense of the public in two ways. First, the net effect would be to shift to taxpayers legal defense costs that should be borne to varying degrees by A/E consulting firms and their insurance carriers. Second, it would encourage protracted litigation because, as a practical matter, a formal finding of negligence or intentional misconduct will be a prerequisite for the public agency to receive indemnity from the A/E consulting firm or its insurance carrier.

AB 573 would give A/E consulting firms an excuse to deny indemnity to public agency clients where there is any plausible contention that the public agency contributed to the loss, even if the A/E consulting firm was primarily responsible. Under most circumstances the public agency's degree of responsibility for a loss is minor and passive compared to that of the A/E consulting firm that was paid to perform a professional service.

The negotiation of terms between public agencies and A/E consulting firms should be left to the free-play of market forces. AB 573 would preclude negotiation of broader protection, even where the public agency is willing to pay extra for such protection. The competitive market for A/E services is robust. A/E consulting firms are experiencing robust growth and do not need any additional protection from the Legislature. (See, Market Returns to Prosperity, *Engineering News Record,* p.54 (4/18/2005).) Public agencies have ample choices for A/E services to deliver their projects. Under these circumstances, it is unnecessary for the Legislature to step in and forbid certain types of indemnity agreements. As with any contract terms, whether the amount of fee or indemnity, A/E consulting firms may always choose to withhold their agreement and do business elsewhere.

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For these reasons, the City of Lodi must respectfully oppose AB 573. We are willing to continue discussions with the sponsors and your office, but until our basis concerns are resolved, we must respectfully oppose the bill.

Sincerely,

D. STEPHEN SCHWABAUER
City Attorney

DSS/pn

cc: Members and Consultant, Senate Judiciary Committee
Sue Blake, Director of Legislative Affairs, OPR
Patrick Whitnell, Assistant General Counsel, League of California Cities